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FILE COPY

Supreme Court of the United States

ARKANSAS CORPORATION COMMISSION, ——— *Petitioner*,

v. No. 715

GUY A. THOMPSON AS TRUSTEE OF MISSOURI PACIFIC RAILROAD COMPANY, DEBTOR, ——— *Respondent*.

BRIEF IN BEHALF OF THE STATE OF ARKANSAS

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STATUTE

Pope's Digest, Section 2019

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ARKANSAS CORPORATION COMMISSION, ... *Petitioner*,

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v.

GUY A. THOMPSON AS TRUSTEE OF MISSOURI PACIFIC RAILROAD COMPANY, DEBTOR, ... *Respondent*.

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF.

Four trunk line railroads which traverse the State of Arkansas are in reorganization proceedings under section 77 of the bankruptcy act. The State and many of its subdivisions have tax claims against each of them, and the State is vitally interested in the questions involved in this case. For this reason I ask leave to file the accompanying brief in behalf of the State as amicus curiae, pursuant to Supreme Court Rule No. 27, paragraph 9.

Respectfully submitted,

JACK HOLT,
Attorney General of the State of Arkansas.

POINTS AND AUTHORITIES RELIED ON

I.

Jurisdiction of the Bankruptcy Court.

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Tagg Brothers v. *United States,* 280 U.S. 420

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In re A. V. Manning's Sons, 16 Fed. Supp. 932

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S.C. 50 Sup. Ct. 220

Department of Public Works v. *United States,* 55 Fed. (2d) 295

Edward Hines Yellow Pine Trustees v. *United States,* 263 U.S. 143, 148

S.C. 44 Sup. Ct. 72

Louisiana P.B. Railway Co. v. *United States,* 257 U.S. 114, 116

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Road Improvement District v. *St. Louis-San Francisco Ry. Co.,* 164 Ark. 442

Paving District v. *Myer,* 158 Ark. 610

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In re 168 Adams Building Corporation, 105 Fed. (2d) 704, (C.C.A. 7)

(d)

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Mississippi Valley Barge Line v. *United States*, 292 U.S. 282

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Virginia Railway Co. v. *United States*, 272 U.S. 658

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New York v. *United States*, 257 U.S. 591, 601

S.C. 42 Sup. Ct. 239

Voehl v. *Indemnity Insurance Co.*, 288 U.S. 162

S.C. 52 Sup Ct. 380

ARGUMENT

I.

Jurisdiction of the Bankruptcy Court.

The jurisdiction of a bankruptcy court in a railroad reorganization proceeding does not stem from section 64a of the bankruptcy act. This question was fully discussed in the supplemental brief in support of the petition for a writ of certiorari, and the argument need not be repeated here.

Taxes which accrue during the pendency of bankruptcy proceedings are a part of the expense of administration.

> *Hennepin County* v. *Savage*, 83 Fed. (2d) 453 (C.C.A. 8)
>
> *Thompson* v. *Louisiana*, 98 Fed. (2d) 108 (C.C.A. 8)
>
> *Boteler* v. *Ingels*, 308 U.S. 57, 521
>
> *Robertson* v. *Goree*, 29 Fed. (2d) 261 (C.C.A. 5)
>
> *Macgregor* v. *Johnson-Cowdin*, 39 Fed. (2d) 574 (C.C.A. 2)
>
> *In re Humeston*, 83 Fed. (2d) 187 (C.C.A. 2)

It is the duty of the bankruptcy court to make an order allowing or disallowing such tax claims filed against the debtor's property. It cannot discharge this duty without determining the validity or invalidity of the tax claims, and it has unquestioned jurisdiction to do this.

The crux of this case is not the question of the power of the court to pass on the validity of a tax claim, but the question of the principles of law which should govern the court in determining its validity.

The trustee contends that section 64a of the bnakruptcy act empowers the court to re-assess the tax and reduce it if the court thinks that it is too high. It is with this in view that the trustee contends that section 64a is a part of section 77. The position of the State of Arkansas is that the court may disallow the tax claim if it finds, in accordance with applicable legal principles, that it is invalid, but that the court cannot itself determine what the proper amount of the tax ought to be.

The purpose of this brief is to discuss the principles according to which the validity of the tax claim should be adjudicated.

II.

The Validity and Amount of Tax Claims Must be Determined in Accordance with the Laws of the Taxing Sovereignty.

This is a universal principle with reference to which there is practically no dissent in the authorities. It applies to bankruptcy proceedings just as it does in all other proceedings. It is bottomed on the sovereign power of the states in taxation matters. If a tax is valid according to the law of the state pursuant to which it is levied, it is valid in whatever jurisdiction, state or federal, its validity is called in question. It has been held that this principle applies even under section 64a.

In re 168 Adams Building Corporation, 105 Fed. (2d) 704, (C.C.A. 7)

Dickinson v. Riley, 86 Fed. (2d) 385 (C.C.A. 8)

In re Gustav Schaefer Company, 103 Fed. (2d) 237 (C.C.A. 6)

It becomes necessary to ascertain, therefore, what the laws of Arkansas are.

III.

The Arkansas Corporation Commission is a Quasi Judicial Tribunal.

Under the laws of Arkansas the commission is a *quasi judicial* tribunal, to which the legislature has committed exclusive jurisdiction to assess taxes due by railroad companies, after notice and with an opportunity to appear and be heard. An assessment of taxes by the commission has the force and effect of a judgment.

> "The board was created for the purpose of using its judgment and its knowledge. Within its jurisdiction, except, as we have said in the case of fraud or clearly shown adoption of wrong principles, it is the ultimate guardian of certain rights. The state has confided those rights to its protection, and has trusted to its honor and capacity, as it confides the protection of other social relations to the courts of law."

Chicago B. & Q. R.R. v. *Babcock,* 204 U.S. 585.

The judicial quality of such tribunals has given rise to the established principle that their decisions cannot be overturned by the courts for mere mistakes of fact or errors of judgment. This principle applies to all *quasi judicial* tribunals.

King v. *M'Andrews,* 111 Fed. 860 (C.C.A. 8)

Smelting Company v. *Kemp,* 104 U.S. 636

Butte A. & P. Ry. Co. v. *U.S.,* 290 U.S. 127

Chicago Railway v. *Kendall,* 266 U.S. 94

Oregon Short Line R.R. v. *Ross*, 52 Fed. (2d) 697

Taylor v. *Secor*, 92 U.S. 575

Southern Ry. Co. v. *Watts*, 260 U.S. 519

IV.

The Trustee did not Exhaust the Administrative Remedy Provided by the Arkansas Statute.

The applicable Arkansas statute is as follows:

"Appeal from Arkansas Corporation Commission to Pulaski Circuit Court. Within thirty days after the entry on the record of the said Arkansas Corporation Commission of any order made by it, any party aggrieved may file a written motion with any member of such commission or with the secretary thereof praying for appeal from such order to the circuit court of Pulaski County; and thereupon said appeal shall be automatically deemed as granted as a matter of right without any further order. The secretary of said commission shall then at once make full and complete transcript of all proceedings had before such commission in such matter and of all evidence before it in such matter, including all files therein, and deposit same forthwith in the office of the clerk of said circuit court, which appeal shall be given preference over all other cases on the docket of said circuit court. Upon the filing of the aforesaid motion of said appeal and at anytime thereafter the said circuit court or its circuit judge shall have the right to issue such temporary or preliminary orders as to it or him may seem proper until final decree is rendered."

Pope's Digest, Section 2019.

It is a universal principle that a tax-payer must exhaust the administrative remedy afforded by law to secure relief

against an alleged illegal tax before he can resort to the courts for that purpose.

Coulter v. *Railroad,* 196 U.S. 599

Pittsburgh Railway v. *Backus,* 154 U.S. 431

Tagg Brothers v. *United States,* 280 U.S. 420

First National Bank v. *Commissioners,* 264 U.S. 308

Hodge v. *County,* 196 U.S. 276

Branson v. *Bush,* 251 U.S. 191

Kansas City Ry. Co. v. *District,* 266 U.S. 379

Denver Union Stock Yard Co. v. *United States,* 57 Fed. (2d) 738

Apartments Building Company v. *Smiley,* 32 Fed. (2d) 142

Kansas City Southern v. *Levee District,* 15 Fed. (2d) 637

Robert Noble Estate v. *Boise City,* 19 Fed. (2d) 928

Union Pacific R.R. Co. v. *Commissioners,* 217 Fed. 540

Thomas v. *Railway,* 277 Fed. 708.

The principle that the property owner must exhaust the administrative remedy provided by law for relief against an alleged illegal tax before he can resort to the courts for that purpose has been held to be applicable to trustees in bankruptcy.

In re Gustav Schaefer Company, 103 Fed. (2d) 237 (C.C.A. 6)

City of Springfield v. *Hotel Charles,* 84 Fed. (2d) 589 (C.C.A. 1)

In re Perlmutter, 256 Fed. 861

In re 168 Adams Building Corporation, 105 Fed. (2d) 704 (C.C.A. 7)

In re A. V. Manning's Sons, 16 Fed. Supp. 932

In re Schach, 17 Fed. Supp. 437

The trustee in the case at bar, instead of exhausting the administrative remedy which presumably would have afforded him any relief that he was entitled to, filed a petition in the bankruptcy court for the bar order involved. He alleged that the court had jurisdiction under section 64a, and he asked the court, not to set aside the assessment made by the commission on the ground that it was excessive and invalid, but to determine as an original proposition what the amount of the tax ought to be.

The district court, in a written opinion filed by it, (record pages 29-34) stated that it was admitted in this case that the trustee did not take an appeal from the Arkansas Corporation Commission to the circuit court of Pulaski county, the administrative remedy provided by section 2019 of *Pope's Digest*, but the court held that the trustee was not required to exhaust this statutory remedy. The court said:

> "The court is of the opinion that this right of appeal granted by the Arkansas statute does not preclude the Trustee from petitioning this court to determine the amount and validity of the disputed tax under the provisions of section 64a of the bankruptcy act." (Record 33)

The court ordered the trustee to pay 60% of the taxes as assessed, the amount conceded by him to be due, and to withold the payment of the other 40% "pending determination by this court of the amount and legality of the taxes

assessed against the property of the Trustee in said respective counties for the year 1939." (Record 21)

This order was affirmed by the Circuit Court of Appeals. The affirmance not only raises the question whether or not a trustee in bankruptcy is required to exhaust an administrative remedy provided by law, like an ordinary property owner, but the further and more vital question whether a court of bankruptcy has any power under the federal constitution to assess values for taxation purposes, or to itself determine what the amount of a tax ought to be.

V.

The Bankruptcy Court has no Power, Under Section 77, to re-assess the Taxes due by the Trustee.

The entire scope and effect of section 77 is to authorize the creditors and stockholders of a railroad company to formulate a reorganization plan, subject to the approval of the interstate commerce commission and of the court, that will be fair and just to the creditors and stockholders, and which will guarantee the continued operation of the railroad. The word "taxes" does not appear in section 77, and there is not a single sentence in the section which remotely indicates that Congress intended to confer on bankruptcy courts the extraordinary power to assess or reassess taxes.

If a tax is valid when measured by the laws of the taxing sovereign the bankruptcy court should allow it. If a tax is invalid when measured by those laws, it is the duty of the bankruptcy court to disallow it. The allowance or disallowance of a tax claim exhausts the entire judicial power of the court. The court cannot in a bankruptcy case, any more than it can in any other character of case, re-assess a tax.

If there is one outstanding principle that has been established by this court it is that a federal court is wholly without power to make assessments of taxes. The assessment of taxes is referable to the legislative power, and it is no part of the judicial function. This is true, as said by this court, "both because that is a function reserved to the states, and because it is not one within the judicial power conferred upon them by the constitution."

Central Kentucky Natural Gas Co. v. *Railroad Commission*, 290 U.S. 264

S.C. 54 Sup. Ct. 154

See also:

West Ohio Gas Company v. *Public Utilities Commission*, 294 U.S. 63

S.C. 55 Sup. Ct. 316

Rowley v. *Chicago & N.W. Ry Co.*, 293 U.S. 102

S.C. 55 Sup. Ct. 55

Great Northern Ry. Co. v. *Weeks*, 297 U.S. 136

S.C. 56 Sup. Ct. 435

Reagan v. *Farmers Loan & Trust Company*, 154 U.S. 362

West v. *Chesapeake and Potomac Tel. Co.*, 295 U.S. 662

S.C. 55 Sup. Ct. 894

Central R. Company v. *Martin*, 115 Fed. (2d) 968, (C.C.A. 3)

This principle has been held to be applicable to tax claims filed in bankruptcy proceedings.

City of Detroit v. *Detroit & Canada Tunnel Co.*, 92 Fed. (2d) 833 (C.C.A. 6)

Cross v. *Georgia Iron & Coal Co.*, 250 Fed. 438

In Re Gould Manufacturing Company, 11 Fed. Supp. 644

In re Schach, 17 Fed. Supp. 437

In re 168 Adams Building Corporation, 27 Fed. Supp. 247

All of the foregoing principles and decisions would go for naught if it should be held, as the Circuit Court of Appeals held, that section 64a is a part of section 77, and it should further be held, as contended by the trustee, that under 64a the bankruptcy court has the power to itself determine what the amount of the tax ought to be.

The trustee relies on *Henderson County* v. *Wilkins*, 43 Fed. (2d) 670 (C.C.A. 4)

This case is out of line with all the bankruptcy cases heretofore cited to the effect that the validity and amount of a tax assessment must be determined by the laws of the taxing sovereign. The claim involved in that case was an *ad valorem* tax on real estate. The court found that the tax assessed by the taxing authorities was too high, and it reduced it to what the court thought it ought to be.

The court based its opinion on *New Jersey* v. *Anderson*, 203 U.S. 483. The *Anderson* case has been more misunderstood than perhaps any other bankruptcy decision.

A statute of New Jersey levied a "license fee" on the stock of corporations. The assessment was made on the basis of $40,000,000.00 of authorized capital stock, whereas it was undisputed that only $10,000,000.00 was issued and outstanding. The court said that the case turned on whether

the imposition was in legal effect a license fee or a tax, and that the nomenclature used in the statute was not conclusive of that question. If the imposition was a license fee, it could legally be levied on the entire authorized capital stock of the corporation. If, on the other hand, it was in reality a tax, it could only be levied on the outstanding stock. This for the obvious reason that a tax cannot be levied on something that does not exist. A majority of the judges construed the imposition as a tax, and held that it only applied to the capital stock which had been issued and which was outstanding. The chief justice and two associate justices took the view that the imposition was a license fee imposed on corporations for the privilege of doing business in New Jersey.

The court stated the specific question which it was called on to decide as follows:

> "The question is, is the claim a tax legally due and owing to the State of New Jersey? We have been cited to many cases in the State of New Jersey, some of which it is alleged maintain the theory of the appellant that this is a tax, and some the contrary view."

An analysis of the *Anderson* case, therefore, demonstrates that it is not susceptible of the interpretation put on it in *Henderson County* v. *Wilkins*. This has been pointed out by other courts.

In re Gould Manufacturing Company, 11 Fed. Supp. 644

In re Schach, 17 Fed. Supp. 437

In re 168 Adams Building Corporation, 27 Fed. Supp. 247

VI.

Trustee's Petition is a Collateral Attack on the Assessment made by the Commission.

One of the reasons why the trustee insists so strenuously that section 64a is a part of section 77, and that the bankruptcy court has the power to determine the *amount* of the assessment without remitting that question to the commission, is to escape the principles which are applicable to a collateral attack on the assessments. Some of the principles are as follows:

(a)

The assessment is prima facie valid.

The findings of *quasi judicial* tribunals, such as the Arkansas Corporation Commission, are presumed to be valid, and the burden of proof is on those who assail their validity.

Kansas City Southern Ry. Co. v. *Road Improvement District*, 266 U. S. 379

S.C. 45 Sup. Ct. 136

Memphis L. & T. Co. v. *St. Francis Levee District*, 64 Ark. 259

Missouri Pacific R. Co. v. *Improvement District*, 137 Ark. 568

Overstreet v. *Levee District*, 80 Ark. 462

Paving District v. *Meyer*, 158 Ark. 610

(b)

The validity of the assessment must be determined on the record before the commission.

It is established, with practical unanimity, that the validity of a finding or judgment of a *quasi judicial* tribu-

nal when challenged in the courts must be determined on the evidence which was introduced before the tribunal. Any other rule would make a mockery of the laws creating such tribunals and investing them with exclusive jurisdiction of the matters confided to their determination.

Louisville & Nashville Railway Co. v. *U.S.*, 245 U.S. 463, 466

State of Florida v. *United States*, 292 U.S. 1

S.C. 54 Sup. Ct. 608

Chicago, I. & L. Ry. Co. v. *United States*, 270 U.S. 287

S.C. 46 Sup. Ct. 227.

Nashville, C. & St. L. Ry. v. *State of Tennessee*, 262 U.S. 318

S.C. 43 Sup. Ct. 583

Louisiana P.B. Ry. Co. v. *United States*, 257 U.S. 114

S.C. 42 Sup. Ct. 25

Spiller v. *Atchison T. & S.F. Ry. Co.*, 253 U.S. 125.

Tagg Bros. & Moorehead v. *United States*, 280 U.S. 420

S.C. 50 Sup. Ct. 220

Department of Public Works v. *United States*, 55 Fed. (2d) 395

Edward Hines Yellow Pine Trustees v. *United States*, 263 U.S. 143, 148.

S.C. 44 Sup. Ct. 72

Louisiana P. B. Railway Co. v. *United States*, 257 U.S. 114, 116

S.C. 42 Sup. Ct. 25

(c)

An assessment made by a quasi judicial tribunal cannot be set aside for mere mistakes of facts or errors of judgment.

If there is one proposition that is more thoroughly settled than others by the decisions of the Arkansas Courts it is that an assessment made by a duly constituted tribunal, like the Arkansas Corporation Commission, cannot be set aside on evidence merely showing that the assessment is excessive. The proof must go very much further. It must clearly and convincingly be made to appear, as said by the Supreme Court of Arkansas, that the assessment was "manifestly outside of the range of the facts so as to amount to an arbitrary abuse of power."

Salmon v. *Board of Directors,* 100 Ark. 366

Moore v. *Board of Directors,* 98 Ark. 117

Board of Directors v. *Crawford County Bank,* 108 Ark. 419

Road Improvement District v. *St. Louis-San Francisco Ry. Co.,* 164 Ark. 442

Paving District v. *Myer,* 158 Ark. 610

Withrow v. *Nashville,* 145 Ark. 345

The federal decisions are to the same effect.

Baker v. *Druesedow,* 263 U.S. 137
S.C. 44 Sup. Ct. 42

Rowley v. *Chicago & N.W.R. Co.,* 293 U.S. 102
S.C. 55 Sup. Ct. 55

Lehigh Valley R. Co. v. *Martin,* 100 Fed. (2d) 139

Fallbrook Irrigation District v. *Bradley,* 164 U.S. 176

Great Northern Ry. Co. v. *Weeks*, 77 Fed. (2d) 405, (C.C.A. 8)

St. Joseph Stock Yards Co. v. *United States*, 298 U.S. 38

S.C. 56 Sup. Ct. 720

In Re Lang Body Co., 92 Fed. (2d) 338, (C.C.A. 6)

In Re 168 Adams Building Corporation, 105 Fed. (2d) 704, (C.C.A. 7)

(d)

Judicial function.

"The judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body."

Mississippi Valley Barge Line v. *United States*, 292 U.S. 282

S.C. 54 Sup. Ct. 694

Virginia Railway Co. v. *United States*, 272 U.S. 658

S.C. 47 Sup. Ct. 222

United States v. *New River Company*, 265 U.S. 533.

S.C. 44 Sup. Ct. 610

Western Paper Makers' Chemical Company v. *United States*, 271 U.S. 268

S.C. 46 Sup. Ct. 501

Louisville & Nashville Railway Co. v. *United States*, 225 Fed. 571, 582

Great Northern Railway Company v. *Weeks*, 77 Fed. (2d) 405 (C.C.A. 8.)

State of Florida v. *United States*, 292 U.S. 1.

S.C. 54 Sup. Ct. 608

Chicago, Rock Island & Pacific Railway Co. v. *United States*, 274 U.S. 29

S.C. 47 Sup. Ct. 486

New York v. *United States*, 257 U.S. 591, 601

S.C. 42 Sup. Ct. 239

Voehl v. *Indemnity Insurance Co.*, 288 U.S. 162

S.C. 52 Sup. Ct. 380

VII.

Conclusion.

It will be conceded that the principles discussed in this brief would be controlling if this were an ordinary suit in equity by the Missouri Pacific Railroad Company against the Arkansas Corporation Commission and the 51 county collectors to annul the assessment and to enjoin the collection of the taxes based on it. The trustee takes the position, however, that none of them are applicable to this case because, as he contends, section 64a is a part of section 77, and that section 64a, as construed in *Henderson County* v. *Wilkins*, 43 Fed. (2d) 670, (C.C.A. 4) absolves trustees in railroad reorganization proceedings from the dominion of state laws and state decisions, and invests courts of bankruptcy with the legislative power of assessing for themselves, on original evidence introduced before them, the value of railroad property for taxation purposes, and of determining the amount of the tax to be paid on such value.

The questions involved are of great public importance in view of the many railroad reorganization proceedings now pending in the courts, and they ought to be authoritatively settled.

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